



STATE EMPLOYEE BENEFITS COMMITTEE
FUND RESERVE ANALYSIS

September 28, 2015

Why Reserves are necessary

- Increases the likelihood that the plan is able to withstand unanticipated financial losses caused by adverse fluctuation in claims, enrollment and other unforeseen changes in the demographic composition of the plan
- Maintaining an adequate reserve means that, to a very high degree of certainty, all obligations of claims and administrative expenses are met
- Helps to ensure the long-term solvency of the plan

Risk-Based Capital (RBC)

- Developed by the National Association of Insurance Commissioners (NAIC) and the American Academy of Actuaries
- Used by most state insurance regulators to measure solvency (minimum reserves) of insurance companies
- The reserve level of the State Health Plan is tied to the Risk-Based Capital (RBC) formula
- Risk Categories:
 - H0 - Asset Risk - Affiliates
 - H1 - Asset Risk - Other
 - H2 - Underwriting Risk
 - H3 - Credit Risk
 - H4 - General Business Risk

Risk-Based Capital (RBC) Risk Categories Defined

- **H0 Asset Risk – Affiliates**
 - This is the risk of assets defaulting for certain affiliated investments
- **H1 Asset Risk – Other**
 - This is the risk of assets defaulting for principal and interest or fluctuation in market value
- **H2 Underwriting Risk**
 - This is the risk of underestimating liabilities from business already written or inadequately pricing business to be written in the coming year
- **H3 Credit Risk**
 - This is the risk of recovering receivables from creditors
- **H4 General Business Risk**
 - This is the risk of general business

Risk-Based Capital (RBC) Formula

- The RBC formula provides an overall assessment of risk by considering covariance between the various risk categories.
- For the State of Delaware Health Fund, only the underwriting (H2) risk applies.
- As it relates to the underwriting risk, modeling for the RBC formula was set up to provide a 95% confidence level that an entity would remain solvent over a 5 year timeframe.
- In 2006, Medicare Part D (EGWP) was added as a separate underwriting risk factor due to the timing of when federal reinsurance and coverage gap discounts get reimbursed.

Risk-Based Capital (RBC) Underwriting Risk Factors

- The following underwriting risk factors are applied to net incurred claims to estimate the experience fluctuation risk in the RBC formula:

Fiscal Year	Medical and Non-EGWP Drug Coverage	Stand-Alone EGWP Drug Coverage
2012	0.092	0.251
2013	0.093	0.238
2014	0.092	0.213
2015	0.092	0.208

Risk-Based Capital (RBC) Formula

- For a typical health insurance company, including how the formula works for the State Health Plan, overall risk is exclusively determined by the H2 component.
- $$\text{RBC Amt} = H0 + \sqrt{H1^2 + H2^2 + H3^2 + H4^2}$$
- Authorized Control Level (ACL) = 50% of the RBC Amt
- RBC Ratio = The Plan's Total Adjusted Capital/ACL Amt
- An **RBC Ratio = 2.0** (referred to as 200% RBC) is defined as the minimum reserve level

Minimum Reserves

- In June 2009, the SEBC adopted a policy establishing a 200% RBC minimum reserve level that was determined to be equal to 10% of previous fiscal year's claims and administrative expenses
- Calculations are performed each July following close of fiscal year
 - 10% of actual expenses of prior fiscal year
 - Original FY10 Minimum Reserve Calculation: \$50M
- In March 2012, SEBC voted to increase 200% RBC level to 205% effective with FY13
 - FY13 Minimum Reserve Calculation at 205% equals: \$62 M

Minimum Reserve – Validating the reasonability of the 10% assumption

Fiscal Year	Prior Year's Claims and Adm Exp	200% RBC Amount	200% RBC Percent
2012	\$562.6M	\$53.2M	9.5%
2013	\$607.7M	\$59.8M	9.8%
2014	\$623.2M	\$66.1M	10.6%
2015	\$688.3M	\$74.3M	10.8%

Percentage is increasing as EGWP becomes a larger portion of the total. EGWP has higher risk factors due to the timing of when reinsurance and coverage gap discounts are reimbursed.

Recommendation: Going forward, use the RBC software to calculate minimum reserves directly.

Minimum Reserve History

Fiscal Year	Prior Year's Claims and Adm Exp	RBC Level	Minimum Reserve
2010	\$513.0M	200%	\$50M
2011	\$549.0M	200%	\$55M
2012	\$562.6M	200%	\$56M
2013*	\$607.7M	205%	\$62M
2014	\$623.2M	205%	\$64M
2015	\$688.3M	205%	\$71M
2016**	\$770.6M	205%	\$79M

* FY 2013 started out the year with a 200% RBC Level of \$61M and SEBC approved 205% in Mar 2012 raising it to \$62M

** Projected

Questions/Discussion/Next Steps